

VZCZCXRO6320
RR RUEHGH
DE RUEHIN #0179/01 0240325
ZNY CCCCC ZZH
R 240325Z JAN 07
FM AIT TAIPEI
TO RUEHC/SECSTATE WASHDC 3844
INFO RUEHBK/AMEMBASSY BANGKOK 3558
RUEHBJ/AMEMBASSY BEIJING 6267
RUEHBY/AMEMBASSY CANBERRA 4437
RUEHKL/AMEMBASSY KUALA LUMPUR 3669
RUEHML/AMEMBASSY MANILA 9932
RUEHGP/AMEMBASSY SINGAPORE 6791
RUEHKO/AMEMBASSY TOKYO 8426
RUEHWL/AMEMBASSY WELLINGTON 1702
RUEHGZ/AMCONSUL GUANGZHOU 9937
RUEHHK/AMCONSUL HONG KONG 7496
RUEHGH/AMCONSUL SHANGHAI 0757
RUEATRS/DEPT OF TREASURY WASHDC
RUCPDO/DEPT OF COMMERCE WASHDC

C O N F I D E N T I A L SECTION 01 OF 03 TAIPEI 000179

SIPDIS

SIPDIS

STATE PASS USTR
STATE FOR EAP/TC,
USTR FOR STRATFORD AND ALTBACH
TREASURY FOR OASIA/LMOGHTADER
TREASURY ALSO PASS TO FEDERAL RESERVE/BOARD OF
GOVERNORS, AND SAN FRANCISCO FRB/TERESA CURRAN
AND NEW YORK FRB

E.O. 12958: DECL: 01/12/2010

TAGS: [EFIN](#) [ECON](#) [TW](#)

SUBJECT: TAIWAN FINANCE MINISTER ON FINANCIAL REFORM

REF: A. TAIPEI 91

- [1](#)B. TAIPEI 63
- [1](#)C. TAIPEI 49
- [1](#)D. TAIPEI 134

Classified By: AIT DIRECTOR STEPHEN M. YOUNG FOR REASONS 1.5 (b), (c)

[1](#)1. (C) Summary: In a January 22 conversation with AIT Director Young, Minister of Finance Ho Chih-ching claimed Taiwan's budget remains a victim of the political confrontation. He said Taiwan's financial stability is sound and that the bank run has not spread beyond Chinese Bank. Ho views the collapse of the Rebar Group and the bank run as an opportunity to push forward some much needed financial sector reform. He hopes to initiate tax reform in 2007 which would eventually result in lower overall marginal rates on personal and corporate income taxes while also eliminating a wide range of sectoral tax incentives. Ho urged action on a bilateral tax agreement. We also raised the Tyco thermistor case, urging Taiwan to find a solution. End Summary.

[1](#)2. (U) AIT Director Young met Minister of Finance Ho Chih-ching January 22 to discuss economic and financial conditions. MinFin was accompanied by Yang Chiao-ing, Section Chief, Department of the National Treasury; Lee Ching-hua, Senior Executive Officer, Department of Taxation Bureau; Denise Dine, Executive Officer, Department of Taxation; and Lillian Hsieh, Senior Specialist, Department of Customs Administration. The Director was accompanied by AIT Deputy Director Wang and Econ Chief.

Budget

[1](#)3. (C) Ho observed that Taiwan increased tax revenues and controlled spending in 2006, successfully narrowing the central government budget deficit. Based on these good results, he had hoped for broad acceptance by the Legislative

Yuan (LY) for the 2007 budget, but now that the political parties are engaged in a political confrontation over the Central Election Commission, he is not confident about what will happen. However, Ho said the government can continue to operate with spending generally limited to last year's levels and that he and his staff will stand by to provide any information required should there be extended LY sessions to consider the budget.

Rebar Scandal

14. (C) Admitting that he and Taiwan's other financial regulators, Central Bank Governor Peng Fai-nan and Financial Supervisory Commission Chairman Shih Jun-ji, had been concerned the run on Chinese Commercial Bank (Refs B and C) (Zhonghua Shang Yinhang) could potentially spread to other vulnerable banks, Ho said he believes the situation has now stabilized, due to quick action by the regulators to guarantee 100 percent of the deposits. He said he and other regulators thought the most critical period in the run on the bank had been Thursday, January 11 because this was the day after a member of the LY publicly listed seven banks that she said Taiwan officials consider to be vulnerable: China Bank; Taitung Business Bank; Enterprise Bank of Hualien; Bowa Bank; Chin Fon United Investment and Trust; and Asia Investment and Trust. (Note: Officials took over Taitung in mid-December and Hualien along with Chinese Bank on January 5. End Note)

15. (SBU) MinFin Ho emphasized there are only four vulnerable banks remaining on the regulator's watch list. (Note: The combined net worth of these four banks is NT\$16 billion or about US\$500 million. End Note.) During that first week, he said the regulators received reports every half hour on the

TAIPEI 00000179 002 OF 003

state of withdrawals for these four vulnerable banks in order to be ready to step in at a moment's notice.

Prospects for Banking Reform

16. (C) When prompted, Ho echoed earlier comments by Vice Premier Tsai (Ref A), suggesting that the Rebar scandal and run on Chinese Bank may offer an opportunity to improve longstanding problems in the financial sector. He said the banking issue has been a potential time bomb that went off January 5. (Comment: Contacts in the financial sector tell AIT/T the problems have not only been apparent for some time, the timing of the run was also anticipated. As early as October last year, financial institutions such as brokerage houses were calling customers and advising them to remove funds from Chinese Bank and place them with other, sounder banks. The typical call/advice did not cite any specific problem with Chinese Bank, just that 'management believes' the customer should shift their funds. End Comment.)

17. (C) Ho said the problems have been cumulative and efforts to defuse it have been hampered by a lack of support in the Legislative Yuan (Note: Referring to the LY sharply slashing proposed funding to deal with vulnerable banks in 2005. End Note.). The problem was exacerbated because individuals simply deposited their funds in banks offering the highest interest rates without any consideration of the soundness of the institution. In his view, common practices in Taiwan's business community, such as cross-holding of equity, are prime problems that have also affected bank operations. Thus, he sees an urgent need to establish more independent Boards of Directors that are committed to good governance practices.

18. (SBU) One approach supported by Ho is to attract more good quality foreign banks to participate in the domestic market. He said Taiwan welcomes foreign banks to bring managerial expertise and take equity positions in Taiwan banks, both private and state-owned ones. He emphasized Taiwan no longer

has any timeline to reduce state ownership in its banks or financial holding companies, but is committed to privatizing gradually. He believes another useful effort would be to educate the public about how to handle finances and to carefully choose institutions to entrust their funds with. He quickly added that the education campaign is a long-term project. The first priority on January 5, and even now, remains to ensure financial stability and to prevent the run on Chinese Bank from spreading to any other institution. Ho said he prefers to "over guarantee" deposits rather than run the risk of financial contagion.

Tax Reform

19. (SBU) MinFin Ho came to office with substantial qualifications as a tax expert and participated in blue-ribbon panels formulating tax reform efforts begun under one of his predecessors, Lin Chuan. When asked about his plans for tax reform, he said he will start in 2007 with a proposal to streamline the estate & gift tax provisions. He wants to reduce the tax rate and implement an exempt amount that parents can pass on to their children, possibly in the range of NT\$7-NT\$10 million. Ho emphasized that the tax revenue implications of his estate & gift tax proposals are quite small. But this is the starting point to produce a more streamlined and equitable tax system. Among expected benefits, this can eliminate a wide range of tax incentives, such as the tax exemptions for high-technology industries and for servicemen and teachers, that have been part and parcel of the system for many years.

TAIPEI 00000179 003 OF 003

110. (SBU) Ho explained that sunset provisions in Taiwan's tax code require a review of the tax system in the next 2-3 years, offering a unique opportunity to enact major changes in Taiwan's tax system. He believes that if done well, tax reform can result in lower rates, higher revenues and a system that is both easier to administer for the government and easier for individuals to file. He foresees the elimination of the highly unpopular alternative minimum tax implemented in 2006 and believes his reforms will also help reduce Taiwan's income gap between rich and poor.

Bilateral Tax Agreement

111. Ho expressed appreciation for renewed U.S. efforts to move forward on negotiating an agreement on avoidance of double taxation. He said Taiwan remains committed to such an agreement and wants to see it completed. The Director said the tax agreement has proven to be a challenge, but that Washington Agencies continue to pursue the issue.

Tyco Thermistors

112. (C) Following up on AUSTR Stratford's discussions on the Tyco thermistor case with Vice Premier Tsai Ing-wen and Minister of Economic Affairs Steve Chen (Ref D), Econ Chief also advised Ho about Tyco's interest in settling the case and its preparations to file a 301 petition. Ho used his prepared points on Tyco, noting the case is very difficult because Customs wants to avoid setting any precedent for other cases that could be pending in the legal system and is reluctant to apply Taiwan's October 2005 reclassification of the thermistors retroactively. He said there are about 1,100 cases still in the Administrative Court system and that all eight cases that have been finally decided by the courts are in the favor of Customs. Ho said Taiwan is still actively thinking about the case, though he would really appreciate any compelling new evidence in the case that would justify Customs altering its position. We also said the 301 petition could make the issue more visible and force USTR to take a stand on the case. (Comment: MinFin did not seem to be

aware that Tyco remains interested in settling the case and welcomed that piece of information. End comment.)
YOUNG